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SUBJECT: MEXICAN AUTO PRODUCTION DECLINES REFLECT DECREASED U.S.
EXPORTS

MONTERREY 00000504 001.2 OF 003

¶1. (SBU) Summary. Nuevo Leon's key automotive industry has suffered serious declines in automotive production and exports, reflecting the weakness of U.S. car demand and the declining fortunes of the Big Three U.S. automakers. While automakers might move some car production to Mexico to reduce costs, this will not be enough to offset the overall decline in sales in the near term. Although the next year or two will be difficult, Mexico should be well positioned as a low cost car and truck producer once the U.S. economy improves. End Summary.

Weakness in the Mexican Automotive Sector

¶2. (U) The automotive industry is critical to Nuevo Leon. According to promotional material from the Nuevo Leon Secretary of Economic Development, Nuevo Leon produces 8.4% of the Mexico's total automotive GDP, estimated at \$1,280 billion USD. The Nuevo Leon automotive cluster includes 145 Mexican companies and 50 foreign companies, many of them American. The automotive industry is also important for the neighboring states of Coahuila and San Luis Potosi, where U.S. companies such as Ford and Chrysler have a major presence. The Mexican auto industry in general is heavily dependent on exports, as 80% of Mexico's total production of 2 million light vehicles in 2007 was exported, primarily to the U.S.

¶3. (SBU) The sharp decline in North American automotive demand is reflected in declining Mexican production. Jose Carlos Pons, Strategic Planning Manager for Nemaak (a major player in the worldwide transmission manufacturing market) reported that North American automotive demand has been over 16 million units per year, but in September the company projected that demand would fall to 13.9 million units in 2008, and subsequently we have heard estimates that total demand will drop further, to 12 million units. Pons thought that North American automotive demand would not recover for several years. Mexican auto production has significantly declined as U.S. demand has faltered. Mexican auto production fell 4.7 percent in August 2008 compared to 2007. The Mexican Association of Automobile Manufacturers stated that Mexico's exports were also down 14.7 percent from August 2007, and Mexico produced 204,854 vehicles in August 2008, down from 215,004 in August 2007. The downturn has also affected supplier sales. Samuel Pena, Foreign

Investment Coordinator for the state of Nuevo Leon, said in September that Nuevo Leon giant Metalsa, producing chassis and other auto components, suffered a 35% reduction in sales between 2007 and 2008. Jose De Nigris, Senior Manager with KATCON, a company which supplies GM of Mexico with Catalytic Converters and Front Exhaust Systems and exports 95% of its production to U.S. Markets, noted reductions in sales from the U.S. slowdown in auto production and recent increases in transport, steel and oil prices. The pessimism about the sector is accelerating. In September, Pena claimed that the decline in U.S. economy would not affect Mexico until early 2009, but recently Pena confided to econoff that the Mexican automotive industry was now in 'very bad shape'.

¶4. (U) The slowdown in exports has resulted in job losses, although the total numbers are hard to quantify. According to data published by the National Institute of Statistics, Geography and Informatics of Mexico

(INEGI), the Mexican automotive and auto parts industry generated 15,640 new jobs in 2007 (an increase of 3.1%), but could lose approximately 6,000 jobs in 2008. There have been a number of anecdotal reports of automotive layoffs, including 500 in Metalsa, 800 at Tal-Port in Saltillo, Coahuila, and 1,700 by autoparts maker Delphi locally and in Chihuahua. Given the forecast declines in automotive production and sales, many more layoffs seem likely.

Possible Offsetting Factors Could Assist the Mexican Auto Industry

MONTERREY 00000504 002.2 OF 003

¶5. (U) Mexico could still benefit as the low cost North American producer since automakers will face pressure to reduce costs by locating in Mexico. According to Pena, a Mexican automotive technician earns \$9,000 USD per year, much less than a Korean (\$20,000) or American (\$25-30,000), but still much more than a Chinese technician (\$2,000). Pena maintained that the Big Three American automakers and other foreign car companies would continue to locate in Mexico to reduce costs, and their suppliers would follow. According to the trade magazine Mexico Now, in 2007 GM and Nissan produced almost 500,000 light vehicles in Mexico, Volkswagen made 400,000, Ford and Daimler Chrysler produced 300,000 units and Toyota perhaps 30,000 units.

In the production of new automotive parts, assembly plants in Mexico are now requiring that their suppliers are as close as possible to them in order to reduce inventory volumes. This shift in production locations has forced many U.S. first- and second-tier suppliers to move to new facilities so they can lower costs and reduce freight and handling expenses in the U.S.

An upcoming U.S. Commercial Service Market Research report has found large investments in 2007 and 2008 by premier companies such as General Motors, Nissan and Toyota. Moreover, Pena contends that the trend towards smaller cars will benefit Mexico, since Mexico focuses mainly on the production of small and medium-sized cars. Note. Mexico also produces trucks and SUVs, such as the production of the RAM truck in Coahuila, which could be negatively affected by this trend. End Note. We also heard from a manager of industrial parks that several automotive suppliers are looking to move to Nuevo Leon, although these moves are dependent on the industrial park locating financing for the companies.

¶6. (U) Mexico could potentially benefit from expanding its domestic market for new cars. The Mexican Association of Automobile Manufacturers (AMIA) reports that Mexican production for the domestic market has remained steady at approximately

400,000 units from 2004 to 2007. AMIA is trying to fend off cheaper imported used cars to support the domestic market for new cars, which carry significantly higher prices than comparable new models in the U.S. AMIA reported that over 3.1 million used cars have been imported into Mexico from the United States since a 2005 Mexican presidential decree allowed imports of cars of between 10 and 15 years of age from the U.S., dragging down domestic sales of new cars. A modified decree, introduced this year in response to local auto industry complaints, now only permits imports of cars that are exactly 10 years old, resulting in a 48% drop in used-car imports. However, as of January 1, 2009, a provision of the North American Free Trade Agreement (NAFTA) takes effect that will allow imports into Mexico of cars of 10 years of age and upwards. Mexico's local auto industry is currently trying to reach an agreement with the government on potential legislation to curb the looming influx of used cars without modifying NAFTA.

Long Term Boom For Mexican Automotive Manufacturers?

¶7. (U) Sergio Ornelas, editor of Mexico Now trade magazine, predicted that after the current slump, the Mexican automotive industry will roar back in 2011 as the low cost North American producer. Monterrey TEC business school dean Salvador Trevino agreed that Mexico could do well in the future, provided that the Detroit Big Three Automakers survive. According to Mexico Now, the Big Three account for over 50% of the automotive production in Mexico.

¶8. (SBU) Comment. There is little doubt that the Mexican automotive industry will suffer a significant decline for the next several years, which will impact employment going forward as production, sales and exports decline. It seems likely that automakers may try to reduce costs by moving more production to Mexico (and increasing the pain in Detroit), but this trend will be overwhelmed by general declines in production for the next two years. Given the probable weakness of the Mexican economy, and the availability of cheaper imported used cars, it seems

MONTERREY 00000504 003.2 OF 003

unlikely that the domestic market for new cars will grow. However, given Mexican cost competitiveness in the region, it is quite plausible that the Mexican automotive industry will emerge stronger than ever once North America resumes its economic growth. End Comment.
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